# Bond Analysis: Grupo Unicomer Co. Ltd. 7.875% 2024

VMWM Research, Business Planning & Investor Relations | July 5, 2023

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- **Bond Recommendations:**

  Appetite for Low Risk: **UNDERWEIGHT**

  Appetite for Moderate Risk: **UNDERWEIGHT**

  Appetite for High Risk: **MARKETWEIGHT**

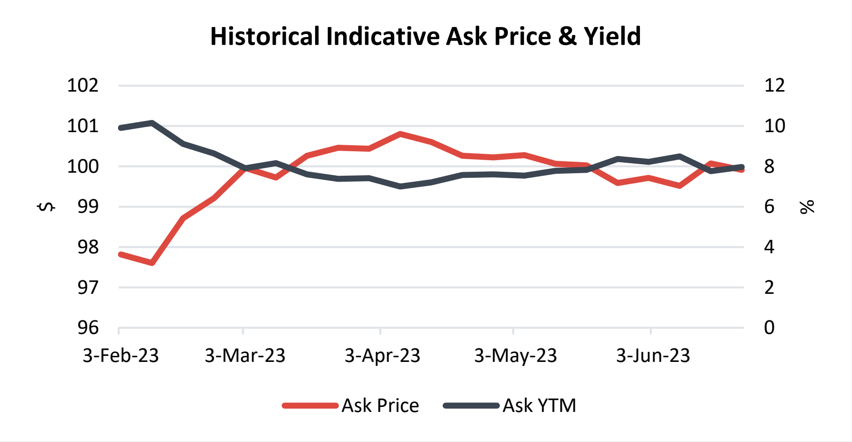
## ABOUT THE COMPANY

With its headquarters in El Salvador, Grupo Unicomer Co. Ltd. (GU) is a retailer of furniture and consumer goods. GU offers home appliances, furnishings for the living and dining rooms, microwaves, gym equipment, audio and video equipment, computers, laptops, beds, and accessories. In addition to services focused on the partial financing of purchases of the products they sell, the Group also provides consumers with short-term cash loans.

GU has subsidiaries in 26 countries across Latin and North America and the Caribbean, operating 1,202 points of sale and 4.2 million square feet of retail space with different store formats and brands. GU has a track record of more than 22 years in consumer durables sales, which has enabled it to develop long-term relationships with suppliers.

GU is privately owned by shareholders Milady Group and El Puerto de Liverpool, S.A.B. de C.V. each of which owns 50.10% and 49.90%, respectively. Both entities are reported to have sound financial positions. Milady's operations include real estate developments, department store chains, and a vertically integrated textile manufacturing and wholesale business. Liverpool, a department store business with 287 units and 28 shopping malls in Mexico, had approximately $7.30 billion in total revenues during 2021.

| Unicomer: Bond Term Summary | |
|---|---|
| **Parent Companies** | Milady Group & El Puerto de Liverpool, S.A.B. de C.V. |
| **Issuer** | Grupo Unicomer Co. Ltd. |
| **Industry** | Retail |
| **Currency** | USD |
| **Issued Amount** | 350,000.00 (M) |
| **Issue Date** | 03/27/2017 |
| **Tenor** | 7 Years |
| **Indicative Ask Price[1]** | 99.916 |
| **Indicative Ask Yield to Maturity[2]** | 7.965 |
| **Coupon** | 7.875% |
| **Credit Rating (S&P)** | B+ |
| **Outlook (S&P)** | Negative |
| **Maturity Type** | Callable on 04/01/2023 @ 100.00 |
| **Maturity** | 04/01/2024 |
| **Day Count Basis** | 30/360 |
| **Use of proceeds** | General Corporate Purposes; Refinance |



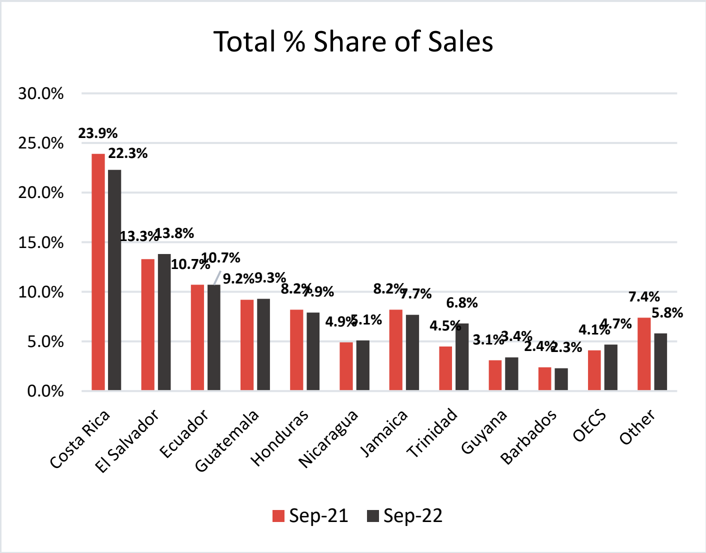

**Recommendation:** Grupo Unicomer (BB-/BB-, S&P/FITCH) has begun rebounding from the impacts of the COVID-19 pandemic, demonstrated by increased sales revenue and EBITDA recorded at the end of FY 2021/22. Despite this improvement, the group has increased its leverage, which saw the debt-to-equity ratio growing. However, the financial fundamentals of the group are expected to benefit from the anticipated increase in the global retail industry and the support from the parent companies.

With less than a year until maturity, bondholders have a low probability of encountering interest rates risks, but the issuer has a high probability of facing a refinancing risk, given its liquidity constraints and recent credit downgrades. Therefore, in a bid to mitigate the possible implications, we recommend underweight for new and existing bondholders with low and medium risk appetites and makeweight for high-risk appetite investors, which can benefit from interest spreads until maturity.

[1] As at June 23, 2023

[2] As at June 23, 2023

## ECONOMIC OVERVIEW (LATIN AMERICA & THE CARIBBEAN)




The Latin America and Caribbean (LAC) region accounted for 94.20% of GU's total sales as of September 2022, up from 92.60% in September 2021. As the world continues to recover from the COVID-19 pandemic and the ripple effects of the ongoing Russia-Ukraine war, the International Monetary Fund (IMF), in its April 2023 edition of the World Economic Outlook (WEO), has lowered the 2023 growth projection for the LAC region from 1.80% in January 2023 to 1.60%, in line with the World Bank's 1.50% projection. While inflation rates across the region are anticipated to have already peaked, higher interest rates within the region and among leading trading partners, along with generally elevated prices, remain downside risks to the growth prospects. Nonetheless, the recent US debt ceiling suspension and a strong labor market are expected to bode well for the LAC region through sustained remittance inflows.

## CREDIT RATINGS

**Standard and Poor's (S&P): B+/Negative**

On June 14, 2023, S&P Global Ratings lowered GU's issuer and issue-level credit ratings to 'B+' from 'BB-' and maintained a negative outlook. According to S&P, GU's liquidity position continues to deteriorate, due to rising short-term debt maturities and tight financing conditions. GU's ability to maintain its profitability and cash flows over the next 12 months may be compromised by the impending purchase of CrediScotia Financiara S.A. (CSF). Additionally, GU is expected to refinance its notes due in April 2024, but rising debt levels and financing costs, together with decreased profitability and cash flow, is expected to continue pressuring GU's credit metrics and liquidity. If the company is unsuccessful in refinancing its 2024 notes, which would further reduce its liquidity, the negative outlook suggests a likely downgrade in the next three months.

**Fitch Ratings: BB-/Stable**

On December 8, 2022, Fitch Ratings affirmed GU's Long-Term Local and Foreign Currency Issuer Default Ratings (IDRs) at 'BB-'. Since GU's financial profile may temporarily deteriorate if the CSF acquisition goes through, Fitch revised the outlook from positive to stable, reflecting their opinion that a rating upgrade is unlikely within the next 12 months. In addition, a bleak macroeconomic environment in the Latin American region presents operating hurdles for GU, which may pull its top line and consequently impact the EBITDA.

## FINANCIAL ANALYSIS

| USD ('000) | FY 2019/20 | FY 2020/21 | FY 2021/22 | 6M Sep 2020/21 | 6M Sep 2021/22 |
|---|---|---|---|---|---|
| **Revenue** | 1,179,172 | 1,128,652 | 1,297,103 | 569,003 | 598,157 |
| **EBITDA** | 238,419 | 169,557 | 241,185 | 109,191 | 97,554 |
| **Interest Expense** | 63,309 | 57,853 | 57,110 | 26,734 | 32,443 |
| **Total Equity** | 574,741 | 531,563 | 544,490 | 478,114 | 558,257 |
| **Long Term Debt** | 600,407 | 534,399 | 601,764 | 555,417 | 610,162 |
| **Short Term Debt** | 178,652 | 115,620 | 209,840 | 150,571 | 279,720 |
| **Total Debt** | 779,059 | 650,019 | 811,604 | 705,988 | 889,882 |
| **Operating Cash Flow** | 351,030 | 347,239 | 318,007 | 154,880 | 150,200 |
| **Total Debt to Equity (%)** | 135.5% | 122.3% | 149.1% | 147.7% | 159.4% |
| **Total Debt to EBITDA (x)** | 3.27 | 3.83 | 3.37 | 3.23 | 4.56 |
| **EBITDA Margin (%)** | 20.22% | 15.02% | 18.59% | 19.19% | 16.31% |
| **Interest Coverage Ratio (x)** | 3.77 | 2.93 | 4.22 | 4.08 | 3.01 |
| **Debt Service Coverage Ratio (x)** | 1.33 | 1.47 | 1.15 | 1.45 | 0.70 |

For the financial year ended March 31, 2022, GU reported sales revenue of $1.30 billion, which represented a 14.92% or $168.45 million uptick over the previous year's reported revenue of $1.13 billion. This was the group's first annualized increase in sales since the onset of the COVID-19 pandemic in 2020, as product sales jumped 15.50% year-over-year. For the period 2019-2022, revenue grew at a compounded annual rate of 1.62%, even as inflation threatened consumer demand. For the six months ended September 30, 2022, GU reported sales revenues of $589.16 million, a 5.12% or $29.15 million increase when compared to revenue of $569.00 million reported for the same period in the previous year.

Following a decline in the financial year 2020/21, EBITDA experienced a 42.24% or $71.63 million year-over-year increase to come in at $241.19 million, in comparison to the $169.56 million yielded in FY 2020/21. The increase was primarily aided by an 82.95% or $70.63 million surge in operating profit, resulting from the growth in sales and diminishing remeasurement of accounts receivables at amortized cost and accounts receivables impairment. Ultimately, the EBITDA margin grew from 15.02% at FY end 2021 to 18.59% at FY end 2022. However, for the six months ended September 2022, EBITDA declined 10.66% to $97.55 million when compared to the same period in 2021. This was owed to a 17.59% fall in operating profit, as the group's expenses mounted in response to elevated inflation and to cover the reported one-off expenses related to IT costs and excess inventory management. Consequently, the EBITDA margin for the six months ended September 2022 contracted to 16.31% versus 19.19% in the prior year.

The group's debt burden increased by 24.86% at the end of FY 2021/22, as both long-term and short-term debt obligations grew. This saw total debt-to-equity rising from 122.28% at the end of FY 2020/21 to 149.06% at the end of FY 2021/22, suggesting a higher risk of refinancing of upcoming maturities in 2024. The debt-to-EBITDA fell to 3.37x in FY 2021/22 from 3.83x in the prior year, due to EBITDA outpacing the growth in total debt. Nonetheless, the decline in interest expenses resulted in the coverage ratio improving from 2.93x to 4.22x, indicating the company's ability to make interest payments, even as interest rates continue to rise.

## S.W.O.T ANALYSIS

| Strengths: | Weaknesses: |
|---|---|
| • Geographic diversification with locations throughout LAC mitigates country risk from exposure to any sole economy.<br>• Stabilizing operations are evidenced by key metrics, such as total sales, reaching above pre-pandemic levels with headroom to weather volatility.<br>• Solid business position that is supported by proprietary financing services and economies of scale in terms of purchasing power and logistics.<br>• Financial support from parent companies. | • The weakening of the company's creditworthiness, stemming from increased leverage and reduced liquidity, has already resulted in credit downgrades, with further downgrades on the horizon.<br>• The consumer discretionary sector, in which GU operates, is susceptible to the impacts of economic volatility. |
| **Opportunities:** | **Threats:** |
| • Cash reserves are anticipated to improve through the reduction in inventory.<br>• Sufficient financial spreads to cover the portfolio's credit risks, derived from an attractive portfolio net yield from the consumer finance strategy. | • Elevated inflation and interest rates may reduce consumer demand for both the retail and financing arms of the company's operations.<br>• Given the approaching maturity of the $350 million notes due in April 2024, debt-maturity risks keep rising.<br>• The upcoming CSF acquisition may increase the company's leverage, via additional debt financing.<br>• Higher interest rates and future ratings downgrade should affect the refinancing costs of the maturing 2024 senior unsecured notes. |

## COMPANY OUTLOOK

**Probable Liquidity and Refinancing Risks, however Expected Support from Parent Company is a Positive**

The global retail industry is expected to continue expanding in 2023, via increased online and in-store purchases. GU stands to benefit as the group aims to reduce its inventory, coupled with the significant stock of accounts receivables due in next twelve (12) months. However, if this reduction is done at a slower than expected pace due to slowing economic activity in the LAC region, the group may encounter liquidity and leverage issues. This can see operating profit and EBITDA falling, along with a significant decline in operating cash flow. Furthermore, additional strain on liquidity is possible if GU uses short-term financing to fund the ongoing purchase of CSF. Liquidity woes may worsen if GU doesn't make any significant headway over the next couple months in refinancing the 7.875% senior unsecured notes due in April 2024. Within less than a year, GU received multiple credit ratings downgrades, which can prove difficult for refinancing obligations. Given the liquidity risks outlined and the downgrades, investors may lose confidence in GU's ability to remain profitable and make interest payments, which can see the cost of refinancing soaring.

Additionally, GU's credit rating may be under more pressure from Milady Associates, the company's 50.10% shareholder, whose credit quality is deteriorating. This is possibly mitigated by an investment grade credit rating for the Company's other shareholder – Liverpool.

**Continued Growth via Expansions**

A significant turning point in GU's operations was marked by the recent opening of two additional distribution centers in Guatemala and Costa Rica. The expansion strategy is intended to improve the group's logistics system and solidify its position as a market leader. With the new distribution facilities, GU will be able to offer services that are more effective, profitable, and customer focused. Additionally, Global Franchising Corporation (GFC), an affiliate of GU, acquired the intellectual property assets and domains of RadioShack in over 70 nations. With more than 2,000 points of sale worldwide for the RadioShack brand under GU, this acquisition solidifies GFC as the brand's primary owner globally, propelling GFC to the top of the technology market and enhancing its value proposition for customers.

## CONCLUSION

Grupo Unicomer has begun showing signs of a rebound from the impacts of the COVID-19 pandemic, evidenced by increased sales revenue and EBITDA recorded at the end of FY 2021/22. Despite this improvement, the group has acquired additional debt, which saw the debt-to-equity ratio increasing at the end of the 6-months ended September 2022. While the EBITDA margin is anticipated to further improve during the upcoming year, it will not be sufficient to deleverage the group, due to an anticipated growth in debt to refinance the 2024 notes and to close the CSF acquisition deal.

Going forward, the financial fundamentals of the group are expected to benefit from the anticipated increase in the global retail industry, thus potentially mitigating the low hanging liquidity and leverage risks. Additionally, the support from the parent companies should be able to safeguard from the financial risks of upcoming acquisitions and maturities. The following recommendations were applied to investors with the following risk appetite:

Appetite for Low Risk: **UNDERWEIGHT**
Appetite for Moderate Risk: **UNDERWEIGHT**
Appetite for High Risk: **MARKETWEIGHT**

**SOURCES**

Bloomberg, GU's Company's Website, S&P, Fitch Ratings, IMF, World Bank, GU's Financial Statements

**DISCLAIMER**



**DEFINITIONS**

- **OVERWEIGHT** - Security is deemed to be undervalued and is expected to outperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **MARKETWEIGHT** – Security is expected to provide similar returns compared to the market in general or at the same pace as comparable companies; neither strongly positive nor negative.
- **UNDERWEIGHT** – Security is deemed to be overvalued and is expected to underperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **ZEROWEIGHT** – This security is substantially distressed or at risk of a shock which may significantly impair its value.